

TEACHERS' RETIREMENT BOARD

INVESTMENT COMMITTEE

SUBJECT: Alternative Investments – Urban & Rural
Private Equity Study

ITEM NUMBER: 15

ATTACHMENT(S): 1

ACTION: _____

DATE OF MEETING: September 5, 2001

INFORMATION: X

PRESENTER(S): Réal Desrochers

Background

One of the 2000/01 Alternative Investment objectives was for “staff to explore the feasibility and potential benefits of private equity investments in under-served urban and rural communities.”

At the September 6, 2000 meeting, the Investment Committee directed Staff and the Alternative Investment Advisor to work with an independent consultant to prepare a study to fulfill this objective. AI staff developed a “Scope of Study” setting forth the necessary focus of the report for the work activity of the consultant providing the research. The Investment Committee approved the scope of this study at the January 9, 2001 meeting. The Milken Institute prepared a contract bid based on the approved “Scope of Study” and was awarded the contract.

Analysis

The Milken Institute has prepared a report that has been reviewed by Senior Investment Management Staff at CalSTRS and the Alternative Investment advisor.

There are two themes that can be taken from the Milken study:

- There are significant demographic changes occurring in the United States, especially in certain states including California. The changing demographic nature of the U.S. appears likely to result in non-whites becoming the “majority” population by the year 2050. While the study does not explain why, it does say the anticipated demographic shift could present investment opportunities for alternative investors.
- According to the Milken study, there is little detailed information available to address many of the issues identified in the proposed “Scope of Study”. An electronic mail message from the

Milken Institute dated August 1, 2001 states “some of the issues raised in that scope cannot be addressed given the youth of this market and the resulting paucity of reported investment data and current knowledge base.” The electronic mail message further states, “Currently such performance data does not exist to the best of our knowledge.” The absence of available information with respect to comparable returns is due to minimal institutional investor activity in this market segment to date. This made it difficult for the Milken study to address many questions regarding investments in under-served urban and rural communities.

Based on the above themes, CalSTRS has the option of pursuing investments in under-served urban and rural markets, an area that shows promise. However, as indicated in the Milken study the size of this “new market” is undetermined and market research information is still not available that clearly demonstrates whether the investment return will be statistically meaningful to a large public pension fund with over \$100 billion in assets.

Furthermore, CalSTRS Board and Staff are subject to fiduciary prudence standards that need to be observed for investing in an area described by the Milken Institute as a “new asset category,” albeit one that represents the highest risk asset class for CalSTRS. Hence, Staff believes a greater research foundation is needed that provides the needed risk and return assessment before CalSTRS can proceed with such investing. Finally, CalSTRS has not been a “first mover” into new investment areas where data does not exist showing the relationship between the risk CalSTRS would be taking and the expected return.

Recommendation

Staff recommends that no further action be taken given the Milken Institute’s inability to find meaningful supporting data to properly address the scope of the study previously approved by the Investment Committee.

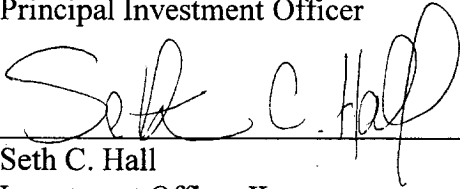
If the Investment Committee seeks to pursue the option of investing in under-served urban and rural communities, further market research and therefore additional funding will be required.

Date prepared: 8/16/01

By:

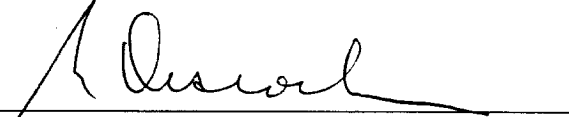


Richard Rose
Principal Investment Officer



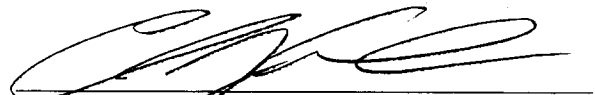
Seth C. Hall
Investment Officer II

Approved by:



Réal Desrochers
Director of Alternative Investments

Review & Concur:



Christopher J. Ailman
Chief Investment Officer